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MMIA v. Bozeman: Insurance, Reinsurance, and the Boundaries of McCarran-Ferguson Reverse Pre-emption

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**PRECAP: MMIA v. Bozeman; Insurance, Reinsurance, and the
Boundaries of McCarran-Ferguson Reverse Pre-emption**

E. Lars Phillips

I. QUESTIONS PRESENTED

Does the Federal Arbitration Act preempt Mont. Code Ann. § 27-5-114(2)(c), which invalidates arbitration agreements in insurance policies except those found in contracts between insurance companies, in spite of the McCarran-Ferguson Act's reverse preemption provision, which delegates the regulation of the business of insurance to the states?

II. INTRODUCTION

This case stems from alleged damages resulting from the “actual and threatened escape of pollutants from the Story Mill Road landfill” in Bozeman.¹

The City of Bozeman presented claims for defense and potential indemnity to Montana Municipal Interlocal Authority (MMIA), a “taxpayer-funded governmental entity created by its member Montana cities and towns” providing pooled risk protection pursuant to Memoranda of Coverage agreements.² On December 15, 2014, following a coverage dispute involving the “absolute pollution exclusion,” MMIA filed a declaratory judgment action to determine its duty to indemnify or defend the City of Bozeman.³ Wescos Insurance Company (“Wesco”), from whom MMIA had purchased reinsurance to cover damages in excess of \$3.5 million, was subsequently notified of the potential claims, and responded that the claims at issue were not covered by the Certificate of Facultative Reinsurance (“the Certificate”) it had issued to MMIA.⁴

III. BACKGROUND

The Certificate issued by Wesco contained a provision requiring arbitration: “Any dispute between the Company [MMIA] and the Reinsurer [Wesco] arising out of the provision of this Agreement, or concerning its interpretation or validity shall be submitted to arbitration[.]”⁵ On December 22, 2014, shortly after MMIA had filed its declaratory judgment action, Wesco demanded arbitration regarding MMIA’s decision to defend the City of Bozeman pending the district

¹ Appellant’s Brief, *MMIA v. Bozeman*, at *3 (Oct. 1, 2105) (No. DA 15-0399).

² *Id.* at *2–3.

³ *Id.* at *3–4.

⁴ *Id.* at *4–5.

⁵ *Id.* at *5.

court's determination of coverage.⁶ MMIA notified Wesco of its objection to arbitration on January 9, 2015.⁷ However, after Wesco notified MMIA that it was moving forward with arbitration proceedings, the arbitration panel convened on February 26, 2015.⁸ Subsequently, MMIA filed a Motion for a Temporary Restraining Order and a Petition for Preliminary Injunction attempting to enjoin arbitration.⁹ On May 15, 2015, the District Court dissolved the Temporary Restraining Order and denied MMIA's request for an injunction.¹⁰

IV. ARGUMENTS ON APPEAL

While both sides use their briefs to fling various arguments across the aisle (MMIA's argues it had no notice of the arbitration provision;¹¹ Wesco argues it "never got its day in [federal] court"),¹² the thrust of the case will likely come down to Mont. Code Ann. § 27-5-114(2)(c) and whether the McCarran-Ferguson Act's reverse preemption provision applies.

A. Appellant Montana Municipal Interlocal Authority

MMIA argues that the arbitration provision in the Certificate is unenforceable as Mont. Code Ann. § 27-5-114(2)(c) invalidates arbitration provisions in "any agreement concerning or relating to insurance policies."¹³ MMIA contends the Federal Arbitration Act's general preemption of state arbitration laws is "reverse preempted" by the McCarran-Ferguson Act's guarantee that "[n]o Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance."¹⁴ MMIA argues that § 27-5-114(2)(c) falls within the ambit of the McCarran-Ferguson Act's broad reverse preemption trigger as it directly regulates the business of insurance.

B. Amicus Curiae Montana State Auditor in Support of Appellant

The Montana State Auditor waded into the fray to contest a particular aspect of the District Court's order, whether the Montana

⁶ *Id.* at *5–6.

⁷ Appellant's Brief, *MMIA v. Bozeman*, at *6 (Oct. 1, 2105) (No. DA 15-0399).

⁸ *Id.*

⁹ *Id.*

¹⁰ Appellee's Answering Brief and Brief in Support of Cross-Appeal, *MMIA v. Bozeman*, at *3 (Dec. 12, 2015) (No. DA 15-0399).

¹¹ Appellant's Br., at *5.

¹² Appellee's Br., at *8.

¹³ MONT. CODE ANN. § 27–5–114(2)(c) (2015).

¹⁴ 15 U.S.C. § 1012(b) (2012).

Insurance Code is the sole method of regulating insurance in Montana, as well as the general question of whether Mont. Code Ann. § 27-5-114(2)(c) is preempted by the Federal Arbitration Act.¹⁵

First, the State Auditor argues that, as the Code provides a directive to “enforce laws related to the business of insurance,” the Auditor’s authority is not limited to the Code itself but to all regulations related to the business of insurance within the Montana Code in general. In support of this proposition, the State Auditor cites numerous provisions that exist outside of the code, but fall within the Code’s directive to regulate the business of insurance.¹⁶

Second, the State Auditor argues that Mont. Code Ann. § 27-5-114(2)(c) is not preempted by the Federal Arbitration Act because of the McCarran-Ferguson Act’s guarantee that the States act as the primary regulators of insurance. The State Auditor cites decisions from other State Supreme Courts, interpreting language almost identical to that at issue in § 27-5-114(2)(c), determining that the statutes were “crafted with the purpose to regulate insurance.”¹⁷

C. Appellee Wesco Insurance Company

Wesco argues that the District Court was correct in determining that the Federal Arbitration Act preempts § 27-5-114(2)(c) for a litany of reasons. First, Wesco argues the statute does not apply to the Certificate at issue because it is not an insurance policy, but rather a reinsurance contract. In support of this contention, Wesco notes that the public policy behind the statute is aimed at protecting unsophisticated insurance policyholders from being forced into arbitration with their insurers. Wesco contends that MMIA is a sophisticated *de facto* insurer and therefore outside the scope of the class the statute was intended to protect.

Second, Wesco argues that because § 27-5-114(2)(c) does not apply to reinsurance the regulation of reinsurance arbitration agreements is an area of law specifically reserved to the Federal Arbitration Act.¹⁸ Third, Wesco contends that the McCarran-Ferguson Act’s reverse preemption doesn’t apply because § 27-5-114(2)(c) does not regulate the business of insurance. To support this contention, Wesco argues that the regulation of insurance in Montana is confined to the Montana Insurance Code.¹⁹

Finally, Wesco argues that even if the McCarran-Ferguson Act’s reverse prevention did apply, the Certificate is a contract between two

¹⁵ Amicus Curie Brief of the Montana State Auditor, *MMIA v. Bozeman*, at *2 (Oct. 1, 2015) (No. DA 15-0399).

¹⁶ *Id.* at *3–4.

¹⁷ *Id.* at *10.

¹⁸ Appellee’s Br., at *16–17.

¹⁹ *Id.* at *17–23.

insurance companies and, therefore, § 27-5-114(2)(c) allows arbitration. Wesco labels MMIA a “de facto insurance company,” citing MMIA’s issuance of coverage opinions, its insurance of members against enumerated risks, and its actions in the underlying lawsuit, which Wesco argues establish MMIA as the functional equivalent of an insurance company.

D. Amicus Curiae Reinsurance Association of America in support of Appellees.

Amicus Reinsurance Association of America (RAA) notes that § 27-5-114(2)(c) allows arbitration agreements between insurance entities as enforceable. The thrust of RAA’s argument is that reinsurance agreements necessarily exist between insurers, and therefore fall under the specific exception found within the statute. RAA defines reinsurance as “insurance for insurance companies,” and argues that arbitration is incredibly important to the reinsurance industry.²⁰ Further, RAA echoes Wesco’s contention that the McCarran-Ferguson Act does not reverse preempt the Federal Arbitration Act in this case as § 27-5-114(2)(c) does not regulate the business of insurance.²¹

V. SUMMARY

Initially, MMIA’s argument appears solid. Invalidating arbitration provisions in insurance policies clearly acts as a regulation on the business of insurance and, therefore, likely triggers reverse preemption under the McCarran-Ferguson Act. Scratch the surface, however, and the argument begins to ring hollow. MMIA’s conclusion that the arbitration provision in the Certificate at issue is invalidated under § 27-5-114(2)(c) relies on a series of assumptions. First, the statute expressly allows arbitration provisions in “contracts between insurance companies.”²² Is MMIA, which provides pooled risk coverage to its member organizations, not an insurance company itself? Second, the public policy behind the statute is likely aimed at protecting unsophisticated policy holders from compelled arbitration with sophisticated insurance companies, meaning MMIA is likely outside the scope of the class the Legislature intended to protect.

On a positive note for policy holders, the arguments seemed to support the conclusion that the McCarran-Ferguson Act does preempt the Federal Arbitration Act where § 27-5-114(2)(c) is concerned, even if it doesn’t prevent arbitration in this case. Further, the State Auditor

²⁰ Amicus Brief of Reinsurance Association of America, *MMIA v. Bozeman*, at *6 (Dec. 9, 2015) (No. DA 15-0399).

²¹ *Id.* at *16–20.

²² MONT. CODE ANN. § 27-5-114(2)(c).

presented a very clear argument as to why the Montana Insurance Code is not the sole method of regulating insurance in Montana.